(5)

NO. 87-1020

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1987

PAUL S. DAVIS,

Appellant

v.

STATE OF MICHIGAN,
DEPARTMENT OF THE TREASURY,

Appellee

ON APPEAL FROM THE
COURT OF APPEALS OF MICHIGAN

BRIEF FOR APPELLANT

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QUESTION PRESENTED

Whether Section 30(1)(h) of the Michigan Income Tax Act [MCLA 206.30(1)(h); MSA 7.557(130)(1)(h)],which completely exempts from Michigan income tax retirement benefits paid to retirees of the State and its political subdivisions, but gives no equivalent exemption to retirement benefits paid to retirees of the Federal Government, is invalid, as applied to Federal retirees, as being in violation of the Federal statute (4 U.S.C. 111), which permits State taxation of compensation of Federal employees only if the taxation does not discriminate against the employee because of the source of the compensation.

PARTIES

The names of all parties to the proceeding are set forth in the caption.

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BRIEF FOR APPELLANT

Paul S. Davis, Appellant herein, a member of the Bar of this Court, appearing pro se, appeals to this Court from the final judgment of the Court of Appeals of Michigan, dated May 5, 1987.

OPINIONS AND JUDGMENTS BELOW

Davis v. Department of Treasury, 160 Mich. App. 98, 408 N.W. 2d 433 (May 5, 1987), set forth in the Jurisdictional Statement (hereafter abbreviated "J.S."), Appendix A, pages A1 to A8.

Davis v. Department of Treasury, 429 Mich. 854 (September 28, 1987), leave to appeal denied; no opinion. Copy of Order is set forth in J.S., Appendix B, page A9.

Davis v. Department of Treasury, Michigan Court of Claims, Case No. 84-9451 (not reported). Oral Opinion is set forth in J.S., Appendix C, pages A10 to A11; Order is set forth in J.S., Appendix D, pages A12 to A13.

GROUND FOR JURISDICTION

Appellant invokes the jurisdiction of this Court pursuant to 28 U.S.C. 1257(2). The issue in this case in-

volves the validity of the Michigan Income Tax as applied to Federal retirement benefits, in the light of the Federal statute (4 U.S.C. 111). This issue was specifically raised in the Complaint (Joint Appendix, hereafter referred to as "J.A.", pages 8-10). It was expressly considered and decided by the Michigan Court of Claims and the Michigan Court of Appeals (J.S. pages A10-11 and A1-8, especially A6-7).

Accordingly, since the case has drawn into question the validity of the Michigan law on the ground of its repugnancy to the Federal statute, and the Court of Appeals decision was in favor of the validity of the Michigan law, this Court has jurisdiction under 28 U.S.C. 1257(2).

Appellant filed his Notice of

Appeal on December 4, 1987 (J.S. A14-15). He docketed the case in this Court by filing his Jurisdictional Statement on December 21, 1987. Both of these dates are prior to 90 days from September 28, 1987, the date of the Michigan Supreme Court's order denying leave to appeal (J.S. A9).

STATUTES INVOLVED

Michigan Income Tax Act, Section 30(1)(h) [1967 Public Act No. 281; M.C.L.A. 206.30 (1)(h); M.S.A. 7.557(130)(1)(h)].

4 U.S.C. 111 (Section 4 of Act of April 12, 1939, codified on September 6, 1966; 80 Stat. 808).

Federal Civil Service Retirement Act (5 U.S.C. 8331 et seq.), Section 8339(a).

The foregoing statutory provisions are set forth in J.S., Appendix F, pages A16-17. 4 U.S.C. 111 is also set forth in the text below, page 14.

STATEMENT OF THE CASE

Appellant is a former employee of the United States Government, and served as such from 1938 to 1942, from 1946 to 1956, and from 1974 to 1980 (J.A. 4). Based on his Government service, Appellant receives Federal Civil Service Retirement benefits, authorized pursuant to the Federal Civil Service Retirement Act (Act of July 31, 1956, as amended; 5 U.S.C. 8331 et seq.)(J.A. 4).

In filing his Michigan Income Tax returns for each of the tax years 1979 to 1984, inclusive, Appellant followed the instructions accompanying the forms prescribed by the Michigan Department of the Treasury, Appellee herein, and included all of his Federal retirement benefits in his taxable income (J.A. 5). Subsequently Appellant filed amended tax returns for

each of these years, in which he excluded his Federal retirement benefits from his taxable income (J.A. 6, 10). In the amended returns and accompanying petitions and claims to the Michigan Revenue Commissioner Appellant petitioned for refunds of his Michigan income tax paid for those years, in so far as based on his Federal retirement benefits (J.A. 6, 10). The Revenue Commissioner denied Appellant's claims for refund. The amounts of such claims for refund for the years 1979 to 1984 aggregated $4,299.53 (J.A. 10, 11).

Following denial of his claims for refund, Appellant filed in the Michigan Court of Claims his Complaint seeking recovery of the Michigan income taxes paid on his Federal retirement benefits (J.A. 1,3-11). In his claims for refund and in the Court of Claims Appellant relied on the Federal statute,

4 U.S.C. 111, and took the position that the Michigan Income Tax Act, by completely exempting Michigan retirement benefits while taxing Federal retirement benefits, was invalid as being inconsistent with the Federal statute (J.A. 7-11).

In the Court of Claims the case was heard on motions for summary disposition, since there was no dispute on the facts (J.A. 1). After the filing of briefs and argument, the Judge of the Court of Claims rendered an Oral Opinion, on October 30, 1985, in favor of the Appellee (J.S., Appendix C, pages A10-11). The Michigan Court of Appeals affirmed the Court of Claims (J.S., Appendix A, pages A1-8). The Michigan Supreme Court denied leave to appeal (J.S., Appendix B, page A9).

Thereafter Appellant filed his Notice of Appeal (J.S., Appendix E, pages A14-15; J.A. 1), and docketed his appeal in this Court.

SUMMARY OF ARGUMENT

Under the doctrine of intergovernmental tax immunity, developed by this Court in the 19th Century, it was established that States could not tax Federal salaries and that the Federal Government could not tax State salaries. Decisions of the Court in this Century gradually limited these principles.

In the Public Salary Tax Act of 1939 Congress specifically applied the Federal Income Tax to State and municipal salaries. Section 4 of that Act (now codified as 4 U.S.C. 111) authorized States to tax the salaries and compensation of Federal officers and employees. However, the latter provision specifically stated that any such State tax must not discriminate because of the source of the pay or compensation.

The present case involves the Michigan Income Tax as applied to Appellant's Federal retirement benefits. Although the State contends that the Federal law applies only to salaries of present Federal employees, Appellant submits that since the statute refers to pay or compensation, and since Federal retirement benefits are based on years of service and past compensation, they are a form of deferred compensation and are within the scope of the statute.

Michigan's Income Tax Act exempts the full amount of the retirement benefits of State and municipal retirees, but taxes Federal retirement benefits subject only to a limited exemption. Accordingly the Michigan Income Tax Act discriminates because of the source of the compensation, and therefore is in violation of 4 U.S.C. 111.

ARGUMENT

I. THE FEDERAL STATUTE, 4 U.S.C. 111, PERMITS STATE TAXATION OF FEDERAL CIVIL SERVICE RETIREMENT BENEFITS, BUT ONLY IF THE STATE DOES NOT DISCRIMINATE BECAUSE OF THE SOURCE OF THE BENEFITS.

The governing statute in this case is 4 U.S.C. 111, which permits non-discriminatory State taxation of Federal compensation. This law was originally enacted in 1939 as Section 4 of the Public Salary Tax Act (53 Stat. 574, 575; Chapter 59, Public Laws of the 76th Congress, First Session, approved April 12, 1939).

Under earlier principles of intergovernmental tax immunity, established by this Court commencing in 1819 in McCulloch v. Maryland, 4 Wheat. (17 U.S.) 316, Federal obligations and compensation were considered constitutionally exempt from State taxation, and

reciprocally State and municipal obligations and compensation were exempt from Federal taxation (Dobbins v. Commissioners of Erie County, 16 Pet. (41 U.S.) 435 (1842) and Collector v. Day, 11 Wall. (78 U.S.) 113 (1870)).

Decisions of this Court in the 20th Century gradually limited the scope of intergovernmental tax immunity. Thus in South Carolina v. United States, 199 U.S. 437 (1905), it was held that the immunity did not extend to a State-operated liquor business, and in Helvering v. Powers, 293 U.S. 214 (1934), the Court sustained application of the income tax to the salary of a transportation utility executive where the utility was owned by a State.

On April 25,1938 President Franklin D. Roosevelt sent a Message to Congress urging legislation applying the Federal Income Tax to income from State and municipal securities and to salaries of

State and local employees (83 Cong. Rec. 5693). A few weeks later, on May 23, 1938, this Court decided Helvering v. Gerhardt, 304 U.S. 405, which upheld applying the Federal Income Tax to an employee of the Port of New York Authority.

Early in the next session of Congress, on January 19, 1939, President Roosevelt sent another Message to Congress reaffirming his earlier Message (84 Cong. Rec. 467). Legislation to carry out his recommendations with respect to Federal and State salaries was promptly introduced and was the subject of hearings and debates in Congress.

While the bill was pending, this Court decided Graves v. New York ex rel. O'Keefe, 306 U.S.466 (March 27, 1939). In that case the Court specifically overruled Collector v. Day, supra, and held that the Federal Income Tax applied to all State and municipal officers and employees. It may be noted that in the

Graves case Solicitor General Jackson appeared for the United States as amicus curiae, and presented a strong argument favoring State taxation of Federal employees' salaries and urging that Collector v. Day be overruled (306 U.S. at pages 472-75).

The Public Salary Tax Act (cited above, page 10) was approved on April 12, 1939. It specifically subjected compensation paid by State and local governments to the Federal Income Tax. However, Congress did not accept the President's recommendation to tax the income from State and municipal bonds.

Section 4 of this Act, which is involved in the present case, granted the consent of Congress to the State taxation of Federal pay or compensation, provided that the tax does not discriminate against the officer or employee because of the source of the pay or compensation. In effect, Congress in

this legislation confirmed the principles of the Graves case, but specified that any State tax must not be discriminatory.

The text of Section 4, codified (with minor changes not here material) in the United States Code as 4 U.S.C. 111, is as follows:

> "The United States consents to the taxation of pay or compensation for personal service as an officer or employee of the United States, a territory or possession or political subdivision thereof, the government of the District of Columbia, or an agency or instrumentality of one or more of the foregoing, by a duly constituted taxing authority having jurisdiction, if the taxation does not discriminate against the officer or employee because of the source of the pay or compensation." (Underscoring added).

Application of 4 U.S.C. 111 to the present case will next be discussed.

II. FEDERAL RETIREMENT BENEFITS ARE WITHIN THE SCOPE OF 4 U.S.C. 111.

Appellant's Civil Service Retirement benefits are paid pursuant to the Civil Service Retirement Act (Act of July 31, 1956, as amended; 5 U.S.C. 8331 et seq.).

The amount of Appellant's retirement benefit is computed under the provisions of 5 U.S.C. 8339(a), and is based on salary and years of service (see J.S. App. F). As stated by the Court of Appeals for the Sixth Circuit in Hogan v. United States, 513 F. 2d 170, 172 (1975), "the amount of the annuity payable on retirement is "directly related to the earnings and years of service of the individual employee." (Underscoring added).

Appellee argued in the Michigan courts that since Appellant is no longer an officer or employee of the Federal Government the provisions of 4 U.S.C. 111 do not apply to him. The Court of Claims and the Court of Appeals accepted that argument. It is submitted that such an interpretation is incorrect, since the scope of the statute is not limited to current Federal rmployees.

The consent expressed in 4 U.S.C.

111 is not phrased in terms of the pay or compensation of a present officer or employee. On the contrary, it expressly covers the "pay or compensation for personal services as an officer or employee of the United States." (Underscoring added). Appellant's retirement annuity is clearly a part of his compensation for his past Government work as an employee of the United States.

The word "compensation" is a broad concept, and is not limited to current salary. In Clark v. United States, 691 F. 2d 837 (1982), the Court of Appeals for the Seventh Circuit reviewed the history and purposes of the Federal Retirement law. The Court stated that the purpose of this statute "is to allow the federal government to compete with the private sector by offering

federal employees an attractive retirement plan." (691 F. 2d at page 842). The Court's opinion went on to refer to the retirement system as "a deferred compensation plan," designed to encourage employees to enter and remain in Government service (page 842; underscoring added).

Similarly, in Kizas v. Webster, 707 F. 2d 524, 536 (D.C. Circuit, 1983), the Court referred to retirement benefits as being one incident of employee compensation. Again, in the recent decision of the Court of Appeals for the Federal Circuit in Zucker v. United States, 758 F. 2d 637, 639 (1985), cert. den. 474 U.S. 842 (1985), the Court referred to the legislative history of the Retirement Act, during which the pension benefits were characterized as "deferred wages."

The foregoing authorities demonstrate that Federal Retirement benefits constitute additional compensation for past services to the Government. Accor-

dingly they are clearly within the scope of the language of 4 U.S.C. 111, covering "compensation for personal service as an officer or employee of the United States," even though not actually paid until after retirement.

III. THE MICHIGAN INCOME TAX ACT DISCRIMINATES AGAINST FEDERAL RETIREES BECAUSE OF THE SOURCE OF THEIR COMPENSATION, IN VIOLATION OF 4 U.S.C. 111.

As set forth above, 4 U.S.C. 111 authorizes State taxation of Federal compensation only when the tax "does not discriminate" because of the "source" of the compensation. The legislative history of this Act shows that Congress was concerned that its consent to State taxation would be granted only where the tax was non-discriminatory.

The House of Reprentatives Committee Report emphasized that the consent of Congress to State taxation of Federal

compensation was "expressly confined to taxation which does not discriminate against such officers or employees because of the source of their compensation." (House of Representatives, Committee on Ways and Means, 76th Congress, 1st Session, Report No. 26, on H.R. 3790, February 7, 1939, page 5).

When the bill was before the Senate Committee Senator Gerry of Rhode Island asked for an explanation of the non-discrimination language in this provision. Senator Prentiss Brown, the Senator in charge of the legislation, stated in reply (Senate Hearings on Public Salary Tax Act, H.R. 3790, February 21, 1939, at page 21):

> "I would say, Senator Gerry, that it is an analogous to the subject of the taxation of national bank stock by a State. We authorized taxation by the State of Rhode Island of any stock held by citizens of Rhode Island in a national bank, and we provide in it that that taxation must be on the same terms and conditions

as taxation of State bank stock by the State of Rhode Island, and I think the idea in this bill is to permit that kind of income tax legislation."

The Report of the Senate Committee stated that the Federal consent to such taxation was to apply only "if such taxation does not discriminate against such officer or employee because of the source of such compensation." (Senate Committee on Finance, 76th Congress, 1st Session, Report No. 112, February 24, 1939, page 11). */

The Michigan Income Tax Act discriminates against Federal retirees because of the source of their compensation, in violation of the express language of 4 U.S.C. 111. The Michigan Act taxes Federal retirement benefits,

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*/ The Senate Committee Report contains an extensive discussion of the constitutional aspects of the legislation, and reviews the various Supreme Court cases on intergovernmental tax immunities as of that time (pages 4-10).

subject only to a limited exemption set forth in subparagraph (iv) of Section 30(1)(h) of that Act (J.S. App. F, page A16). On the other hand, the Michigan Act expressly exempts the full amount of retirement benefits received from a public retirement system of the State or any of its political subdivisions (subparagraph (i) of Section 30(1)(h)). Clearly this constitutes a discrimination against Federal retirees based on the source of their compensation.

In Memphis Bank & Trust Co. v. Garner, 459 U.S. 392 (1983), this Court held invalid a Tennessee statute taxing bank earnings, which was defined to include interest on United States obligations but did not include interest on State obligations. The Court held that this statute discriminated "in favor of securities issued by Tennessee and its political subdivisions and against

federal obligations," and that this constituted an unconstitutional discrimination. The Court concluded that "the Tennessee bank tax impermissibly discriminates against the Federal Government and those with whom it deals." (459 U.S. at 399).

Appellant had cited the Memphis case before the Michigan Court of Claims and the Michigan Court of Appeals. In its opinion below the Michigan Court of Appeals suggested that this precedent was inapplicable in the present case because Federal obligations are not involved. Appellee has made a similar argument in this Court in his Motion to Dismiss or Affirm (pages 14-18).

Appellant does not contend that his retirement benefits are to be treated as a Government security of which the interest is specifically exempt under another Federal statute (31 U.S.C. 3124), quoted in Appellee's Motion

to Dismiss (pages 16-17). Appellant does assert, however, that the Memphis case is a clear precedent showing a discrimination against Federal retirees, in violation of 4 U.S.C. 111.

The Michigan Court of Appeals in its Opinion in this case discussed the distinction in the Michigan Tax Act "between State retirees and all other retirees," and treated it in terms of the equal protection clause (160 Mich. App. at pages 104-05; J.S., pages A6-A7). The Court found a "legitimate state objective"(page 105; J.S.,page A7). Appellee in his Motion to Dismiss or Affirm has also argued that the case is one of "reasonable classification" and "not a discrimination case" (Motion, pages 18-21).

However, the language of 4 U.S.C. 111 does not permit classifying State and Federal retirees differently.

Appellant does not question the right of the State to favor its own retirees as against non-Federal retirees. But Appellant submits that the Federal law (4 U.S.C. 111) forbids discrimination against Federal retirees.

Other decisions of this Court emphasize that a State may not discriminate against Federal activities. Phillips Chemical Co. v. Dumas Independent School District, 361 U.S. 376 (1960), cited in the Memphis case, supra, invalidated a tax which was imposed on lessees of property owned by the Federal Government, but which exempted lessees of property owned by the State and its political subdivisions. The Court considered this to be a "substantial and transparent" discrimination against the Government and its lessees (361 U.S. at page 387).

Similarly, in Moses Lake Homes v. Grant County, 365 U.S. 744 (1961),

this Court held invalid a tax on lessees of Federal property, where their leaseholds were assessed at the full value of the land and improvements, but other leaseholds were assessed at their fair market value excluding the value of the improvements.

In the recent case of City of Manassas v. United States, ___ U.S. ___, 108 S.Ct. 1586, 99 L.Ed.2d 884 (April 25, 1988; No. 87-1117) this Court affirmed the decision of the Court of Appeals for the Fourth Circuit in United States v. City of Manassas, 830 F.2d 530 (1987). That case held invalid personal property taxes imposed by a Virginia municipality on property furnished by the United States for use by a Government contractor. The Virginia statute expressly exempted from this tax property owned by the Virginia Port Authority and some local

transportation districts. The Court of Appeals relied particularly on the Phillips case, supra, and held that the discrimination was not justified and that the tax was invalid.

In South Carolina v. Baker, ___ U.S. ___, 108 S.Ct. 1355, 99 L.Ed.2d 592;56 L.W. 4311 (April 20, 1988; No. 94, Orig.), the Opinion of the Court analyzed past cases on intergovernmental tax immunity (Part III). In summarizing the current law, the Court pointed out that taxes may be imposed against parties doing business with the Government "as long as the tax does not discriminate against the United States or those with whom it deals"(99 L.Ed.2d at page 610; 56 L.W. at page 4316).

The foregoing authorities demonstrate that the Michigan Income Tax Act unlawfully discriminates against Federal retirees, and is therefore in violation of 4 U.S.C. 111.

CONCLUSION

On the basis of the facts and the law, it is submitted that the Michigan Income Tax Act, in taxing Federal retirement benefits while exempting those of State retirees, creates an unlawful discrimination because of source, in violation of 4 U.S.C. 111.

Accordingly this Court should reverse the decision of the Michigan Court of Appeals and remand the case with directions to (1) decree that the Michigan Income Tax Act is invalid in so far as it taxes Federal retirement benefits; and (2) enter judgment for Appellant against Appellee, for the taxes paid on such benefits, commencing with the tax year 1979, together with statutory interest.

Respectfully submitted,

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